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# **China, Peoples Republic of**

## **Tobacco and Products**

### **Tobacco Update**

### **2000**

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#### **Report Highlights:**

**Planted area and production are forecast to remain stable through 2001. Tariff reductions will accelerate under WTO, providing increased access to both cigarettes and leaf tobacco. U.S. tobacco leaf will gain access to the Chinese market in 2001, though initial shipments may remain modest.**

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## Executive Summary

Planted area and production have remained stable during 2000, and are forecast to remain so during 2001. Cigarette production rose slightly, resulting in a continued drawdown of domestic stocks. Due to high tariffs and licensing and quota restrictions, trade remains a small fraction of the domestic market. These barriers will decline as WTO rules goes into effect, and China's imports of leaf tobacco and cigarettes are expected to rise by roughly 10% and 10-20%, respectively, over the next several years. Relatively slow growth in demand for blended cigarettes may slow growth in tobacco leaf imports, however. The Chinese government has agreed to drop its ban on imports of U.S. tobacco, and imports could begin as early as 2001. Counterfeiting of cigarettes remains a problem for China, but recent statistics indicate that some progress has been made.

## Production

Preliminary statistics from the State Tobacco Monopoly Administration (STMA) indicate that planted area and production fell slightly in 2000, and are forecast to remain constant in 2001. This continues the stable trend of the past three years, following major changes in 1996 and 1997. This stability can be attributed in part to STMA policies which penalize local STMA offices caught purchasing over quota, and which control processing and sales of tobacco. While overall production of leaf tobacco is falling, production of oriental tobacco is reported to be on the increase. Although oriental tobacco constitutes only a small proportion of total production, both the Chinese government and foreign companies have shown interest in expanded production of oriental tobacco for blending. STMA currently plans to invest RMB 10 million to develop an experimental production base this year, and the Philip Morris Company is reported to be producing high quality oriental tobacco in the province of Xinjiang. China's Western Development Project is likely to add momentum to this trend, as oriental tobacco is traditionally grown in western provinces such as Xinjiang.

According to STMA, Chinese companies expect to produce 34.25 million cases of cigarettes in 2000, rising gradually to 40 million cases in 2010. As of the end of September, 2000, total cigarette production for the year had reached 24.85 million cases, a 2% increase over the same period in 1999. During the first 9 months of 2000, total industrial and commercial tax revenue from tobacco increased by 11% to US\$2.59 billion. Tax revenues from tobacco remain one of the Chinese government's most important sources of income, amounting to some 10% of total revenue.

Relatively low production levels, combined with increased consumption, have allowed the Chinese government to liquidate a significant proportion of its surplus stocks of leaf. Stocks are estimated to have fallen by well over 500,000 MT in 2000, with further reductions forecast for 2001. This supply gap, along with increased access under WTO and the growing emphasis on quality, will create increased opportunities for exports of foreign tobacco to China.

## Consumption Trends

China consumes over 1.6 trillion cigarettes per year, and in 1999 accounted for over 38% of the world's cigarette sales (FAS, Tobacco World Markets and Trade). The smoking population numbers over 350 million, with smokers constituting 37% of the total population over 15 years old. Smoking is heavily skewed toward males, with 63% of the male population and only 4% of the female population smoking. This situation appears to be changing, however, as Ministry of Health statistics indicate that the fastest growth in consumption is among women and people under the age of 18. The average age when people begin to smoke has fallen by 3

years, and the number of cigarettes smoked has increased to an average of 15 per day for regular smokers. Needless to say, these trends have elicited concern on the part of the Chinese government, and bans on smoking in public venues have been instituted, though they are widely ignored.

The production and sale of high-quality cigarettes have increased rapidly, as rising incomes and growing health concerns are causing consumers to shift in the direction of higher quality. This trend has been reinforced by the STMA's policy of limiting production volumes while improving quality. Consumption of blended cigarettes continues to grow, albeit at a modest pace. The increased emphasis on quality has led to a greater involvement by foreign tobacco companies in China's domestic industry. Foreign cigarettes are now legally produced in China, and are treated as domestic products for tax purposes. Foreign brands currently being produced in China include Camel (Fujian and Jilin provinces), Winston (Fujian), and Rothman and Black Cat (Shandong). Philip Morris recently signed a contract to produce cigarettes in Tianjin, and Japan Tobacco has also reached an agreement with a Chinese company to produce two JT brands domestically. To remain competitive and to address (in a very limited way) consumers' health concerns, the Chinese government is pursuing an aggressive effort to reduce the tar content in domestic cigarettes. From 1989 to 1999, STMA claims that tar levels have been reduced from 21.53 mg to 16.62 mg, with the final goal for 2000 being 15 mg. Much of this decline is the increase in production of filtered cigarettes.

Though cigar consumption remains low, Cuban cigar companies are also increasing their presence. One company has already established a sales presence in Shanghai, and is bringing veteran cigar rollers to China to assist in production. Though price remains a major obstacle for Cuban cigars, Cuban producers believe that China's fast-growing upper class will provide a good market. At present, Cuban cigars are available only in the cities of Beijing, Shanghai, Xiamen, Dalian and Ningbo.

Tobacco advertising is banned in China, however tobacco companies continue to conduct promotions in local bars and nightclubs. While anecdotal evidence indicates that direct-marketing activities have declined, some companies have circumvented the restrictions on television advertising by using the name of a group that includes non-tobacco interests as well. Some companies sponsor major sporting events, while others have purchased sports teams to affiliate their brand with the sport. China's tobacco industry has also pressured the government to relax the ban, reasoning that such a ban prevents Chinese producers from developing the kind of brand recognition that foreign companies already enjoy.

## Trade

China has insulated its domestic tobacco market through the use of an arcane system of import and export restrictions that hark back to the planned economy. For example, Chinese cigarette companies wishing to import tobacco must submit a request to STMA in the preceding year, requiring them to not only register the amount they intend to import, but what country they will import it from. Tariffs and taxes also present a substantial barrier, though these have fallen in advance of China's accession to the WTO. In 1999, the government imposed a 40% tariff on imported leaf, with a consolidated tax amounting to 64%. For cigarettes, the tariff rate fell to 36% (compared to a record 150% in 1997), with a consolidated tax (including tariff) of 218%.

These reductions will continue once China accedes to the WTO. As a condition of membership, China has agreed to reduce tariffs on leaf tobacco to 10% by 2004, and cigarettes down to 25%. For cigarettes, tariff reductions will be accompanied by the gradual elimination of the current quotas and licensing controls that limit

legal sales of imports to tourist hotels and similar venues. More significant for U.S. exporters, China agreed in May to permit imports of U.S. leaf tobacco, which were banned due to concerns over Tobacco Blue Mold. While the import protocol is still being negotiated, access for U.S. tobacco is likely in 2001. Industry analysts estimate that, under WTO rules, imported leaf could eventually gain a share of up to 10% of China's market, while imported cigarettes could reach 10 to 20% of total sales. Growth in imports of leaf tobacco is likely to be slow, however, due to the limited demand for blended cigarettes, much of which may be met by increased imports of cigarettes, and to the lead time required for Chinese companies to develop their own blends. U.S. tobacco will also have to compete directly with Brazilian tobacco, which is already present in the Chinese market. Chinese buyers have noted that high prices relative to other sources may limit imports of U.S. leaf.

In response to WTO, STMA is pursuing a strategy centered around increased exports of cigarettes to offset losses in domestic sales. The first concrete step was taken in September, with the establishment of the Chinese Tobacco Import and Export Group, chaired by the Director General of STMA, with general authority over tobacco exports. This group has, in turn, granted independent trading authority to the Yunnan Tobacco Monopoly, which controls tobacco supplies in China's largest tobacco producing province. The group also met with British American Tobacco in October, signing a letter of intent for further cooperation. Having gained independent trading authority, the Yunnan Tobacco Monopoly (YTM) is now developing its own survival strategy. This may include the sale of shares in Yunnan's tobacco enterprises to foreign tobacco companies in order to gain access to both capital and foreign expertise. Such an action, however, would require central government approval. At least one Yunnan tobacco trader (Yunnan Enterprise Holdings) is also seeking to diversify, moving into the fields of biomedicine and information technology.

Exports for 2000 are now forecast to fall by 15% down to 96,100 MT, with an even sharper drop in export values. Import statistics for the first three quarters of the year attribute the decline primarily to a drop in exports to Egypt and the Philippines. Exports of non-flue cured tobacco, which constitute a small proportion of the total, rose during the first three quarters of 2000. Imports of leaf tobacco are now forecast to reach as high as 45,000 MT in 2000, due in part to tariff reductions. Imports from Brazil and Zimbabwe are likely to account for the entire amount of the increase, based on year-to-date import data. For 2001, imports are forecast to increase by only a small margin, despite China's entry into the WTO, since most cigarette companies have made their procurement plans for 2001 under the current import quota system. China remains a net exporter of cigarettes, though both imports and exports are forecast to fall slightly in 2000. China's primary export markets for cigarettes are Hong Kong, Singapore, Malaysia and Australia. During the first 9 months of 2000 the highest average value for exported cigarettes was \$42/thousand for Singapore, while the lowest was \$4.7/thousand for Uruguay.

## **Tales From the Counterfeit Wars**

The Chinese government, prompted by STMA, continues to press forward with its campaign against counterfeiting and illegal cigarette production. The cost of counterfeiting to the government is substantial: according to STMA the annual loss in tax revenues alone amounts to roughly \$720 million. Despite the crackdown, the problem remains. One likely reason is that the business is simply too lucrative to ignore: domestic sources estimate that the cost-profit ratio for counterfeiters may run as high as 300-400%. Counterfeiters have proven persistent, and have acquired increasingly advanced equipment. The number of brands counterfeited has grown from 30 in 1997 to 100 in 1999, including 35 different kinds of counterfeit Marlboros. Underground plants can be complex affairs which include package printing, paper rolling, packing and transportation facilities. Chinese counterfeits have turned up overseas: in Japan, police recently confiscated

counterfeit Mild Seven and Seven Star brand cigarettes from China, while counterfeit Marlboros have made it as far as Europe.

In response, the Chinese government has increased its efforts to crack down on counterfeiting: in the first half of 2000, the government reported 100,000 police cases involving counterfeit cigarettes, and 1,500 illegal plants were closed, resulting in the confiscation of 3.1 billion cigarettes. In August, police and STMA inspectors in Sichuan province closed down one of the largest counterfeit factories in Chinese history, confiscating 6 complete sets of production equipment. In addition to closing illegal factories, STMA is attempting to undercut counterfeiters by establishing a new system of permits for tobacco procurement. The government has also tightened control over the production of cigarette paper, shutting down 26 mills that had been producing substandard cigarette paper.

Industry sources report that counterfeiting has declined in 2000, and industry statistics for the first nine months of the year bear this out, showing improved sales for legally produced cigarettes. Despite this, most sources believe that the government crackdown has only been marginally successful. The real reason for the drop in counterfeiting, these sources claim, is the shift in consumer demand toward high-quality and low-tar cigarettes. While some counterfeits are remarkably good imitations, the majority are of notoriously poor quality. (One past case turned up counterfeit cigarettes made from tree leaves treated with sulfur). While it is likely that counterfeiters will respond with improved products, the ability of small scale operations to do so is doubtful.

## Statistical Tables

### Production, Supply and Distribution Tables

Table 1. Unmanufactured Tobacco

PSD Table						
Country:	China, Peoples Republic of					
Commodity:	Tobacco, Unmfg.					
		1999		2000		2001
	Old	New	Old	New	Old	New
Market Year Begin		01/1999		01/2000		01/2001
Area Planted	1300000	1374000	1265000	1358000	0	1360000
Beginning Stocks	3754450	3874000	3252891	3149888	2779351	2504419
Farm Sales Weight Prod	2480000	2469990	2406000	2441227	0	2445000
Dry Weight Production	2083200	2074792	2021040	2050631	0	2055000
U.S. Leaf Imports	0	0	500	0	0	500
Other Foreign Imports	10481	10481	10700	45000	0	50000
TOTAL Imports	10481	10481	11200	45000	0	50500
TOTAL SUPPLY	5848131	5959273	5285131	5245519	2779351	4609919
Exports	113259	113259	113480	96100	0	110000
Dom. Leaf Consumption	2471500	2685645	2381100	2600000	0	2600000
U.S. Leaf Dom. Consum.	0	0	500	0	0	500
Other Foreign Consump.	10481	10481	10700	45000	0	50000
TOTAL Dom. Consumption	2481981	2696126	2392300	2645000	0	2650500
TOTAL Disappearance	2595240	2809385	2505780	2741100	0	2760500
Ending Stocks	3252891	3149888	2779351	2504419	0	1849419
TOTAL DISTRIBUTION	5848131	5959273	5285131	5245519	0	4609919

Table 2. Cigarettes

PSD Table						
Country:	China, Peoples Republic of					
Commodity:	Tobacco, Mfg., Cigarettes					
		1999		2000		2001
	Old	New	Old	New	Old	New
Market Year Begin		01/1999		01/2000		01/2001
Filter Production	1629350000	1599850000	1600000000	1661000000	0	1661100000
Non-Filter Production	45300000	42650000	43000000	51500000	0	51550000
TOTAL Production	1674650000	1642500000	1643000000	1712500000	0	1712650000
Imports	3439796	1805443	1805000	1751000	0	1800000
TOTAL SUPPLY	1678089796	1644305443	1644805000	1714251000	0	1714450000
Exports	22831511	7437185	7400000	7157000	0	7250000
Domestic Consumption	1655258285	1636868258	1637405000	1707094000	0	1707200000
TOTAL DISTRIBUTION	1678089796	1644305443	1644805000	1714251000	0	1714450000



## Trade Tables

Table 3. Flue Cured Tobacco Imports

China's 2000 Flue Cured Tobacco Leaf Imports By Country of Origin					
(Metric Tons)					
(2401.2010)	Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec	Year-Date
(2401.1010)	2000	2000	2000	2000	2000
Zimbabwe	18,756	554	475		19,785
Brazil	12,874	0	0		12,874
China	0	276	66		342
Indonesia	20	0	0		20
Others	0	0	17		17
Total	31,649	831	558	0	33,038
China's 2000 Flue Cured Tobacco Leaf Imports By Country of Origin					
(U.S. Dollars)					
(2401.2010)	Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec	Year-Date
(2401.1010)	2000	2000	2000	2000	2000
Zimbabwe	92,043,132	2,568,770	2,312,406		96,924,308
Brazil	47,328,492	619	235		47,329,346
China	0	1,095,736	64,220		1,159,956
Indonesia	145,277	0	0		145,277
Others	0	0	9		9
Total	139,516,901	3,665,125	2,376,870	0	145,558,896
Source: PRC Customs Statistics					

Table 4. Flue Cured Tobacco Exports

China's 2000 Flue Cured Tobacco Leaf Exports					
(Metric Tons)					
(2401.2010)	Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec	Year-Date
(2401.1010)	2000	2000	2000	2000	2000
Indonesia	4,369	5,252	5,337		14,958
Vietnam	2,129	3,919	6,411		12,459
Russia	2,241	3,623	3,608		9,472
Egypt	1,468	656	1,986		4,110
United Kingdom	364	2,264	987		3,615
Philippines	672	1,210	1,566		3,448
Belgium	294	2,475	158		2,927
United States	1,503	1,032	317		2,852
Germany	1,218	1,114	317		2,648
Japan	1,226	1,069	0		2,295
Others	2,584	3,708	2,171		8,462
Total	18,067	26,320	22,858	0	67,246
Source: PRC Customs Statistics					

China's 2000 Flue Cured Tobacco Leaf Exports					
(US Dollars)					
(2401.2010)	Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec	Year-Date
(2401.1010)	2000	2000	2000	2000	2000
Indonesia	9,239,036	10,996,299	10,835,848		31,071,183
Russia	2,841,508	4,067,463	4,010,527		10,919,498
Philippines	1,596,968	2,928,761	2,657,295		7,183,024
UK	620,417	3,958,295	1,743,970		6,322,682
Egypt	2,304,453	1,195,112	2,813,491		6,313,056
Vietnam	1,062,696	1,649,509	2,833,865		5,546,070
United States	2,285,638	1,733,991	604,800		4,624,429
Japan	2,541,264	2,057,702	0		4,598,966
Germany	1,942,505	1,961,292	658,030		4,561,827
Belgium	763,225	3,242,258	384,912		4,390,395
Others	4,939,110	6,649,072	4,842,545		16,430,727
Total	30,136,820	40,439,754	31,385,283	0	101,961,857
Source: PRC Customs Statistics					



Table 5. Non-Flue Cured Tobacco Imports

China's 2000 Non-Flue Cured Tobacco Leaf Imports By Country of Origin					
(Metric Tons)					
(2401.2090)	Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec	Year-Date
(2401.1090)	2000				
Turkey	0	0	400		400
Thailand	35	210	50		295
Zimbabwe	0	79	20		99
Brazil	71	0	18		89
Italy	0	0	7		7
Nepal	2	0	2		4
Total	109	289	496	0	893
(U.S. Dollars)					
Turkey	0	0	1,867,139		1,867,139
Thailand	111,623	664,100	155,103		930,826
Zimbabwe	0	444,327	111,182		555,509
Brazil	274,890	0	69,142		344,032
Italy	0	0	42,924		42,924
Nepal	604	0	387		991
Total	387,117	1,108,427	2,245,877	0	3,741,421
Source: PRC Customs Statistics					

Table 6. Non-Flue Cured Tobacco Exports

China's 2000 Non-Flue Cured Tobacco Leaf Exports By Destination					
(Metric Tons)					
(2401.1090)	Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec	Year-Date
(2401.2090)	2000	2000	2000	2000	2000
United States	0	1,195	100		1,295
Egypt	291	930	651		1,873
Philippines	449	0	0		449
Russia	205	436	0		641
Japan	0	166	0		166
Others	27	72	62		161
Total	973	2,800	813	0	4,586
China's 2000 Non-Flue Cured Tobacco Leaf Exports By Destination					
(U.S. Dollars)					
(2401.1090)	Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec	Year-Date
(2401.2090)					
United States	0	4,051,906	257,776		4,309,682
Egypt	132,231	1,790,299	856,109		2,778,639
Philippines	1,119,744	0	0		1,119,744
Russia	188,784	463,404	0		652,188
Japan	0	311,909	0		311,909
Others	44,366	105,624	95,745		245,735
Total	1,485,125	6,723,142	1,209,630	0	9,417,897
Source: PRC Customs Statistics					

Table 7. Cigarette Imports

China's 2000 Cigarette Imports By Origin					
(1,000 Pieces)					
(2402.2000)	Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec	Year-Date
	2000	2000	2000	2000	2000
United Kingdom	226,398	188,728	309,247		724,373
United States	57,741	97,557	123,039		278,337
Hong Kong	28,405	43,389	37,038		108,832
Japan	27,377	18,043	50,479		95,899
China	10,450	18,681	20,706		49,837
Switzerland	6,500	12,010	8,000		26,510
Germany	10,513	4,255	2		14,770
Luxembourg	3,228	2,217	4,070		9,515
Other	1,375	1,556	2,244		5,175
Total	371,987	386,436	554,825	0	1,313,248
China's 2000 Cigarette Imports By Origin					
(U.S. Dollars)					
(2402.2000)	Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec	Year-Date
	2000	2000	2000	2000	2000
United Kingdom	4,263,314	3,841,001	6,174,873		14,279,188
United States	1,104,831	1,783,996	2,173,438		5,062,265
Hong Kong	363,685	582,466	598,118		1,544,269
Japan	435,285	292,507	804,698		1,532,490
China	169,060	320,927	389,949		879,936
Switzerland	103,350	202,548	123,350		429,248
Germany	235,923	99,758	94		335,775
Luxembourg	52,356	35,893	66,911		155,160
Other	20,575	16,983	38,002		75,560
Total	6,748,379	7,176,079	10,369,433	0	24,293,891
Source: PRC Customs Statistics.					

Table 8. Cigarette Exports

China's 2000 Cigarette Export Volume By Destination					
(1,000 Pieces)					
(2402.2000)	Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec	Year-Date
	2000	2000	2000	2000	2000
Hong Kong	591,645	757,318	547,514		1,896,477
Singapore	174,040	10	12,000		186,050
Malaysia	271,606	296,400	171,020		739,026
Australia	113,120	92,018	128,000		333,138
Canada	60,000	76,000	48,000		184,000
Italy	64,000	32,030	76,800		172,830
Japan	42,308	51,909	107,473		201,690
Uruguay	95,000	98,900	73,260		267,160
United States	8,250	52,900	85,900		147,050
Others	294,676	460,253	484,866		1,239,795
TOTAL	1,714,645	1,917,738	1,734,833	0	5,367,216
China's 2000 Cigarette Export Value By Destination					
(U.S. Dollars)					
(2402.2000)	Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec	
	2000	2000	2000	2000	2000
Hong Kong	11,633,356	14,120,129	10,595,892		36,349,377
Singapore	4,082,502	3,385,660	342,200		7,810,362
Malaysia	3,189,390	335	2,148,161		5,337,886
Australia	2,052,588	1,823,457	2,494,496		6,370,541
Canada	1,507,547	1,962,892	1,232,288		4,702,727
Italy	1,367,662	676,844	1,365,760		3,410,266
Japan	455,774	556,895	2,274,456		3,287,125
Uruguay	473,961	443,546	347,368		1,264,875
United States	81,023	673,835	506,242		1,261,100
Others	3,124,857	4,537,804	5,460,760		13,123,421
Total	27,968,660	28,181,397	26,767,623	0	82,917,680
Source: PRC Customs Statistics.					